BRIEF FOR PETITIONER.

Statutes and Regulations Involved.

Sec. 26 (c)(2) Revenue Act of 1936, C. 690, 49 Stat. 1648, and Treasury Regulations 94 promulgated under the Revenue Act of 1936, Article 26 (c)(2) are set forth in the Appendix of Petition, pp. 9-11.

Statement.

Appears in Petition, pp. 2-5.

Question Presented.

Where a taxpayer corporation threatened with bankruptcy enters into a written contract with the trustee for its creditors requiring said taxpayer to pay to such trustee a stated amount upon the sale of each unit of its sole product and commodity sold by it during each week, is the contract so entered into one which "expressly deals with the disposition of earnings and profits of the taxable year" within the meaning of Section 26 (c)(2) of the Revenue Act of 1936?

Argument.

The question herein presented has never been passed on by this Court. Various Circuit Courts have come to conflicting conclusions as to the interpretation of Sec. 26 (c)(2). Credits on undistributed profits taxes are of sufficient importance to merit a review.

The only objection raised by the Commissioner to granting taxpayer credits authorized by Sec. 26 (c)(2) of the Revenue Act of 1936 is that the contract of taxpayer with the Trustee contains no provision which expressly deals with the disposition of earnings and profits. The 6th Circuit, in the case *Commissioner* v. *Michigan Silica Co.*, 124 Fed. (2nd) 397, had before it the question of a contract

requiring taxpayer to pay under a trust indenture twenty-five cents per ton of sand sold by it during each preceding month to a trustee, who was to deposit the money so paid in a sinking fund and at least once during the fiscal year to use the moneys for the redemption or purchase of taxpayer's outstanding bonds. Even though the trust indenture did not expressly use the terms earnings or profits, it was held in said case that the statute does not require that such terms be used, but only that the written contract contain a provision which expressly deals with the disposition of earnings and profits of the taxable year. The payments in this case, it is to be noted, were unit payments for each unit of sale. The 6th Circuit affirmed per curiam the decision of the Board of Tax Appeals recorded in 41 BTA 511, which held that the contract involved was one entitling taxpayer to a credit under Sec. 26 (c)(2).

The 3rd Circuit had before it in the case of *Clover Splint Coal Co.* v. *Commissioner,* 130 F. (2d) 52, the question of a contract arising out of a mortgage indenture which provided that the taxpayer was to pay a fixed sum for each ton of coal mined. The 3rd Circuit, while it decided against taxpayer and disallowed the credit under Sec. 26 (c)(2), indicated that its decision disallowing the credit was reached because there was no requirement that the coal mined be sold, and hence the payments were not directly tied in with the sales, earnings and profits of taxpayer. In that case also there was no proof offered that the taxpayer had no other source of income or profit.

In *Helvering* v. *Moloney Electric Company,* 120 F. (2d) 617, the 8th Circuit refused to allow a credit under Sec. 26 (c)(2) because the agreement requiring taxpayer to pay the trustee of its bond sinking fund on June 1st of each year "2% of the largest amount of bonds at any time outstanding" was not conditioned on the existence of earnings in that year. In other words, the payments required by the

contract could have been made from other earnings or accumulated profits of taxpayer and did not expressly deal with the disposition of earnings and profits of the taxable year.

Similarly, in *C. C. Clark, Inc.* v. *U. S.*, 126 F. (2d) 292, the 5th Circuit refused to allow deductions of payments required to be made out of the income of the corporation without regard to the sources. The 5th Circuit stated that the credit allowed by Sec. 26 (c)(2) may be taken only upon payments made during the taxable year from profits earned during the taxable year.

Nevada Massachusetts Co. v. *Commissioner*, 128 F. (2d) 347, involved a Maine corporation which had purchased assets of the bankrupt Pacific Tungsten Company. The Maine corporation was organized by the creditors of the Pacific Tungsten Company, and the agreement in that case recited that the taxpayer "out of the net proceeds of the operation of the said mining property of the said Pacific Tungsten Company * * * and out of any other money which the said corporation may have available * * * it will pay". The 9th Circuit felt that this contract did not expressly deal with the earnings and profits of the petitioning taxpayer as required by Sec. 26 (c)(2), but rather with the earnings and profits of the Pacific Tungsten Corporation, and it also felt that under the contract in question taxpayer could make its payments not only out of earnings and profits but out of other money which the corporation may have available.

In the instant case the record is clear that taxpayer was a bankrupt corporation and had no means of making payments except out of its sales earnings (R. 24); that it had one and only one source of earnings, viz.: the sale of its only product, beer; that profit, if any, to the corporation had to be realized out of the sale of this sole product, beer (R. 37); that it had agreed to make a unit payment on each unit of

sales (R. 24), and that the *unit of payment selected was the highest amount of profit possible on each unit of sale* (R. 19, R. 37). The payments of taxpayer were irrevocably made to the Trustee for taxpayer's creditors (R. 10 to 16). Taxpayer had to give monthly statements and quarterly audits, and the salaries of taxpayer's officers were specifically limited during the term of the agreement (R. 14 and 15).

Taxpayer therefore feels that under the interpretation placed on Sec. 26 (c)(2) by the Circuit Court in the 6th, 3rd, 8th, 5th and 9th Circuits, as indicated in the above mentioned cases, it would be entitled to the credits allowed by Sec. 26 (c)(2). Taxpayer further feels that the said interpretation is at variance with the interpretation placed on the said Section by the 2nd Circuit, which held in its opinion in this case that it must "look to the contract alone". In fact, it is respectfully submitted that this taxpayer under its contract had "no legal escape from making the payments out of earnings and profits". If this test, viz.: that taxpayer must have no legal escape from making payment out of earnings and profits, enunciated by the 2nd Circuit in its decision in the instant case had been followed, it is respectfuly submitted that the said court would have come to a contrary conclusion. *This taxpayer's unit payments were at the highest possible profit per unit of sales* (R. 19, R. 37).

There remains for consideration the case of *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, 311 U. S. 46. This case involved a deficit corporation of the State of Washington. Under the statutes of the State of Washington, a deficit corporation could make no distribution of profits by dividends. The Northwest Steel Rolling Mills, Inc., claimed that its charter with the State of Washington constituted a contract, and that under that contract it could not under Washington law distribute profits by way of dividends, and

hence was entitled to a credit under Sec. 26 (c) (1). This case obviously did not involve any interpretation of credits to be allowed under Sec. 26 (c) (2) covering contracts which "expressly deal with the disposition of earnings and profits of the taxable year". The only reference in the *Northwest Steel Mills* case to Sec. 26 (c) (2) was one to the effect that since Sec. 26 (c) (2) required a "written contract executed by the corporation", it must be presumed that Congress intended that there be a similar type of written contract under Sec. 26 (c) (1).

It is respectfully submitted that the question herein presented has not been passed on by this Court; that there is obvious difference of opinion among the various Circuit Courts as to the interpretation of Sec. 26 (c) (2); that credits to taxpayers on undistributed profits tax are of such importance today as to call for a review of the question herein presented, especially since Congress in its last tax bill has made provision for credits to deficit corporations.

It is, therefore, requested that the petition for a writ of certiorari be granted.

Respectfully submitted,

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